Testimony of

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Executive Summary:

Changes in the electric utility industry could affect agriculture. On the one hand, the stability of electric cooperatives, which put consumers first, and which have their own power supply provides a safeguard against volatility in the supply, cost and quality of electricity. On the other hand, the electric utility industry is moving toward the same boom and bust cycle so prevalent in energy. Electricity market conditions today mirror those of more than 60 years ago, when electric cooperatives became the business model for rural electrification.

A number of unanswered questions muddy the future for rural electricity consumers and for agriculture. Among them are: 1) Reserve capacity – we do not know what adequate reserves for electric generation are in a competitive wholesale market; power plants are separated from the traditional responsibility to serve, and no one is charged with planning to ensure that capacity is adequate; 2) Transmission capacity – transmission capacity in the Nation is clearly inadequate and Congress is currently contemplating huge incentives for transmission investment for which there is a better alternative, i.e., removing the risk from transmission investment and providing at-cost transmission through Regional Transmission Organizations; 3) FERC regulation of electric cooperatives – FERC regulation of not for-profit, consumer-owned and governed electric cooperatives is proposed, ostensibly to deal with the issue of alleged price gouging and profiteering in California. Self-governing cooperatives have no part in creating the problem in California and should not be regulated by FERC; 4) Retail Competition – even in Pennsylvania, cited as a state in which retail competition is said "to work," there is no competition for rural and agricultural consumers; repeal of the Public Utility Holding Company Act would allow investor-owned utilities to shed their sparsely populated rural and agricultural areas and target their investments elsewhere; 5) Coal Transportation Charges – many electric utility generating cooperatives are captive rail shippers and cannot enter into competitive contracts with the railroads.

Not-for profit, consumer-owned cooperatives are—and should continue to be—consumer-friendly, stable players in the Nation's electricity markets. Cooperatives are sensitive to balancing environmental and energy concerns; their contemplated investment in new generation facilities, including renewables, is $4.3 billion over the next three years. Cooperatives continue to create jobs and opportunity in rural America, and from 1989 – 1999 leveraged $195 million in loans and grants into an additional investment of $1.1 billion resulting in the creation of 26,000 new jobs. Cooperatives continue to provide essential community services like Internet access and, tele-medicine and distance learning.

Chairman Lucas, Members of the Subcommittee, for the record, I am Glenn English, CEO of the National Rural Electric Cooperative Association (NRECA), the national association of 900 not-for-profit, consumer-owned electric utilities that provide central station electric service to more than 34 million consumers, most of whom live in the nation's rural areas.

I commend you, Mr. Chairman, and the Subcommittee for convening this hearing on energy supply and demand issues affecting agriculture. The cost, availability and, increasingly, the quality and reliability of electricity are critical factors that affect the economics and efficiency of agriculture.

The U.S. electric power industry is transitioning towards a competitive environment in the wholesale and retail markets.

What's happening with electricity today, Mr. Chairman, is that the electric industry is very likely to join the boom and bust cycle so prevalent in energy. The market will drive prices and profits up when power is in short supply and down when it isn't. To the extent that electricity prices get pegged to the short-term fluctuation of energy prices such as gas, the problem will be yet worse.

The last thing the American farmer needs—the farmer who already has to live with commodity prices—is wild fluctuations in the price of electricity. The stability of electric cooperatives—our business model— puts consumers first is derived from our objective to provide for the long-term needs of our owner/consumers. This characteristic should help rural community economic development efforts.

As expected, we are learning things as the transition of the electric power industry takes place. All of what we are learning will ultimately affect agriculture and rural America.

Restructuring Raises Questions on Generation and Transmission Capacity Margins

In the electric business, extra capacity is needed to act as a buffer against unexpected increases in consumer demands and losses of generating supply. Between 1978 and 1992, U.S. electric capacity margins averaged between 25 and 30 percent. Since the 1992 Energy Policy Act that sought to inject competition in the wholesale electricity markets, capacity margins have declined to about 15.6 percent nationwide.

- We do not know what the generating capacity margins need to be in a competitive wholesale market.

- We do know that current generating capacity margins are not adequate and blackouts and brownouts are likely in several areas of the country this year under normal weather conditions.

1. In recent years, a tornado in Oklahoma and a tree that contacted a power line in the Pacific Northwest have resulted in multi-state, regional outages.

2. Non-utility generators and power marketers have been able to use their relatively small positions in the power markets to withhold power until their price demands were met, thus creating previously unheard of levels of price spikes.

Non-utility generators produce power mostly for wholesale markets. Non-utility generation capacity in U.S. markets has increased from about 6 percent of total generation capacity in 1991 to almost 20 percent in 1999.

Restructuring Separates Power Plants from a Utility's Responsibility to Serve

And, with the introduction of competition, wholesale power trading has increased substantially. Power marketers buy and sell electricity, but they do not own or operate transmission or distribution facilities. Although over 500 companies are classified as power marketers, actual sales by power marketers are concentrated in approximately 50 companies. With the growth in power marketing companies, the volume of power trades has increased significantly in recent years. In the first quarter of 1995 power marketers traded 1.8 million megawatthours (MWH) of electricity. By the first quarter of 1999, trade by power marketers had increased to over 400 million MWH.

- In the aftermath of deregulation of wholesale facilities, no one is responsible any longer for capacity planning. Capacity additions respond to the market and other conditions, and may or may not keep pace with the growth in demand. Thus, uncertainty about power supply is likely to be a more frequent part of many consumers' lives.

California's total current capacity is about 55,000 megawatts (MW) and peak demand in the state was 51,547 MW in 2000.

- When ownership of power plants is separated from the utility's responsibility to serve, and the obligation of power plant owners is to maximize profits, market power can be exercised even with a relatively small amount of generating capacity.

- Corporate structure is important in the functioning of electric power markets. The ability of holding companies to move money out of regulated utility subsidiaries into non-regulated activities and overseas investments can affect regional power markets and the availability and cost of electricity to consumers as is being evidenced in California.

- The regulated electric utility industry provides transparency in utilities' financial transactions; transfers of cash from a utility to a holding company are reported and public. Similarly, transactions of electric cooperatives and the federal power marketing administrations are public. On the other hand, the entry of power marketers into the Nation's electricity markets results in the removal of a significant percentage

of market transparency; key information necessary for the formulation of policy is not available from this segment of the industry.

California Raises the Issue of Appropriate Federal Role

Mr. Chairman, as you know, Congress is currently engaged in a debate about what, if any, federal response is appropriate in dealing with blackouts and brownouts facing California and the western U.S. this summer. Some Members of Congress believe the federal government should impose temporary price caps on wholesale electric power transactions in emergency conditions. Others believe equally strongly that price caps send the wrong signal to the marketplace and at the wrong time. NRECA is not engaging in that debate.

However, the Chairman of the Federal Energy Regulatory Commission (FERC), Curt Hébert, has stated in testimony that FERC cannot make price caps work and cannot prevent price gouging in the west because FERC does not regulate electric cooperatives, municipally owned utilities, and federal power marketing agencies (PMAs). Scapegoating cooperatives with a "red herring" issue to justify Chairman Hébert's unwillingness to deal with the problems in California is wrong. Here is why:

- **Cooperatives are consumer-owned and consumer-controlled.** Electric cooperatives are owned and operated by local electric consumers on a not-for-profit basis and according to their own needs. The idea that cooperatives are engaged in manipulation of electric facilities to create market volatility to profit from price swings is ludicrous!

- **Cooperatives are not the problem in California or the West.** Cooperatives do not have market power in California. No rural electric cooperative in California has electric generation. In 2001, the amount of electric cooperative wholesale sales in California from cooperatives in the western region was only 2,244 megawatthours (MWH). In 2000, the amount of electric cooperatives' wholesale sales was approximately 0.2 percent of the total electricity sales to meet the load need of the California Independent System Operator (California ISO). Generation and transmission electric cooperatives in the western region are generating energy to help meet the needs of their cooperative membership. In total, electric cooperative power generation in the west is between 2 percent and 3 percent of the market.

- **FERC and the Secretary of Energy have already exercised authority over cooperatives in an emergency.** On December 14, 2000, Arizona Electric Power Cooperative received an emergency order from the DOE Secretary requiring the sale of electricity into California. Because Arizona Electric Power Cooperative is a summer peaking system, it had power available. On December 15 an order established a $150 per MWH breakpoint mechanism for bids involving the California electricity market. Arizona Electric Power Cooperative complied with both orders.

- **Electric cooperatives can be part of the solution if obstacles are not put in their way.** Three generation and transmission cooperatives in the upper Midwest are winter peaking systems, and will have energy available this summer that could be sold into the western market. Forcing cooperatives that are now regulated by the Rural Utilities Service (RUS) to be regulated the second time by FERC if they sell this power to the western market will be an obstacle to those sales.

Transmission Capacity Debate: Incentives vs. At-Cost, Risk Reduction for Transmission Owners

Mr. Chairman, electric transmission lines provide the transportation system to move electricity from the generation sources to concentrated areas of consumers. From there, the distribution system moves the electricity to where the consumer uses it. The transmission systems are unique because they are designed to move electric energy at the speed of light from the generator to the consumer since there is no long-term storage capability. The National Electric Reliability Organization (NERO) (formerly the National Electric Reliability Council (NERC), the Electric Power Research Institute (EPRI) and the Nation's electric cooperatives report that transmission facilities are inadequate to handle the number of transactions that are occurring on it. Other committees of Congress are looking at federal policies to provide incentives to investors in hopes that they will build additional transmission.

Electric cooperatives believe that the Nation is more likely to get adequate transmission if the interests of consumers are placed first, before the interests of absentee investors. A better proposal for consumers is to eliminate the long-term risk to transmission ownership posed by the possibility of stranded investment through the construction of merchant power plants and distributed generation. Those long-term risks can be eliminated by providing a regional authority like a Regional Transmission Organization (RTO) with the authority to approve transmission facilities and enter them in the regional rate base for the period of their useful life. If those risks are eliminated by assuring transmission investments will be recovered over a period of twenty-five to thirty years, and if financing is available over that period of time as well, transmission will be built and provided at much less cost to consumers.

Retail Competition Doesn't Work for Rural Areas; PUHCA Repeal Could Compound the Problem

Mr. Chairman, some believe that retail electric competition will assure lower electric rates, and Pennsylvania is being cited as an example of where retail competition works. Please note that in rural Pennsylvania, no company is offering to compete for electric consumers. Rural consumers still must provide themselves with electricity through their cooperatives if they are to have it at all.

Congress is considering the repeal of the Public Utilities Holding Company Act (PUHCA). Repeal of PUHCA will provide the large utility companies with the opportunity to diversify and to select those retail markets in which they want to compete

according to the targeted return they are seeking in their business plan. Already, some utility companies are shedding themselves of sparsely populated service territories. If PUHCA is repealed, utility companies are likely to shed themselves of all remaining sparsely populated service territories. Consumers in those areas are likely to have no choice in electric service other than to provide themselves with electricity through a cooperative.

Fortunately, electric cooperatives exist today. There are those in Congress who believe that the solution to electricity supply problems in the nation today can be solved by providing huge incentives to companies of investors. No role is seen for consumer-owned systems. The proposed National Energy Security Act (S. 388 and S.389) is an example. There is a better way. Congress should put consumers' interests first, and provide incentives to consumer-owned cooperatives in equal measure to incentives to companies of investors. For all consumers in the nation to benefit, there must be competition between corporate structures, like cooperatives, municipally owned systems, investor-owned-utilities, and independent power providers.

Electric Cooperatives Today

What follows is a quick thumbnail sketch of the electric cooperative network today. Electric cooperatives today provide service in 83 percent of the Nation's counties or county-like jurisdictions. Electric cooperatives have built and maintain more than 2 million miles of distribution lines, nearly 50 percent of the distribution lines in the Nation, to serve 11 percent of the population. Electric cooperatives serve an average of 6 consumers per mile of line and derive annual revenues of $8,156 per mile of line. Cooperatives have an average capital investment of $2,446 per consumer.

By comparison, investor-owned utilities provide service to 35 customers per mile of line, have an average per-customer investment of $2,080, and derive annual revenues of $62,866 per mile of line; municipal utilities serve an average of 39 customers per mile of line, have an average capital investment of $2,053 per customer, and derive annual revenues of $63,988 per mile of line. Electric cooperatives generate 41 percent of the electricity they provide to consumers; the remainder of their electricity supply comes through agreements with investor-owned utilities or through contracts with the federal power marketing administrations and from public power entities and from marketers and non-utilities.

All segments of the electric utility industry receive some kind of federal financial assistance. Electric cooperatives utilize loans from the Rural Utilities Service in the Department of Agriculture and receive an annual per-consumer subsidy of $13. Investor-owned utilities receive federal benefits through the tax code and receive an annual per-consumer subsidy of $41 per consumers. Municipal utilities utilize tax-exempt financing and receive an annual per-consumer subsidy of $65. An attachment explains these figures in more detail. Current figures on relatively new players in the electric utility industry, power marketers, are not available.

The mission of electric cooperatives for more than 60 years has been to provide at-cost, reliable electricity to rural America. Cooperatives have been extraordinarily successful in meeting that business objective and will do so far into the future. Agriculture has been extraordinarily successful in utilizing electricity to become the most efficient food and fiber production industry in the world.

That success is the result of several well thought-out business and policy decisions.

Cooperatives "Live in the Community"

Electric cooperatives are consumer-owned and consumer-governed. As locally autonomous businesses, cooperatives have developed the knowledge and experience to understand and respond to particular service and community needs. Locally elected boards of directors have the flexibility and ability—and the agility—to adjust priorities as consumers' and communities' needs grow and change. Co-ops don't have to wait for a decision from an absentee board of shareholders with no knowledge or concern for a local community to decide on a course of action to meet these needs.

A significant benefit of consumer ownership is that the dollars spent in the local community stay in the local community. Electric cooperatives provide high-skilled, good-paying jobs that contribute to the vibrancy of the local economy. RUS loans to cooperatives for electric purposes create jobs: for every $1 million in RUS loans, 51 jobs are created, about half in construction and the rest in the supply of goods and services to electric utilities. These are not part-time, minimum wage, make-work jobs: These are jobs for skilled and unskilled workers that pay well and carry benefits for employees.

Electric cooperatives also meet other community needs through their economic and community development activities. These efforts create jobs and opportunity in the community. From 1989 – 1999, four hundred thirty-nine electric cooperative borrowers, through the *Rural Economic Development Loan and Grant Program*, utilized $131 million in loans and $64 million in grants (to set up revolving loan funds) to leverage other funds of $1.1 billion to create 26,000 jobs, not counting jobs associated with industrial buildings, water and sewer projects or community projects, and not counting rural jobs that were saved. This is but one example of how cooperatives work to improve their communities.

Other activities include the provision of Internet service, emergency radio transmission sites, distance learning and medical link programs and a host of others. A host of "soft" activities like having meter readers check on elderly residents and lighting the Little League field also contribute to the quality of life in rural communities.

On the rural electric co-op agenda, the consumer always comes first. Those things that affect the rates, reliability and safety of consumers are uppermost in the mind of every cooperative board of directors.

Cooperative Stability in a Volatile Marketplace

Electric cooperatives have invested wisely in infrastructure. Today, cooperatives produce about half of the electricity they need to meet consumer needs. Given today's volatile marketplace, the decisions to invest in long-term supply facilities exhibit remarkable foresight.

Because of those decisions, many cooperatives are shielded to a greater or lesser degree from that volatility. For example, Anza Electric Co-op in California. I have attached to my written testimony a news story that Members of the Subcommittee will find interesting and revealing.

You know, Mr. Chairman, today's volatility, the mergers and acquisitions, the threats of market power—these are poignantly reminiscent of why cooperatives came into being in the first place more than 60 years ago. It was in response to precisely these market conditions that the Rural Electrification Administration was created in 1935.

In a nutshell, Anza Electric Cooperative, in Anza, California, has not experienced the rolling blackouts and brownouts that have characterized the California electricity market. As the story points out, Anza is part-owner of a generating plant in Benson, Arizona—with other cooperatives—that provides its power.

The bottom line is that Anza is an example of a better way to approach electric service, of what consumers can do through their cooperatives. Again, cooperatives have invested wisely in building generation and transmission facilities to provide their consumers with at-cost electricity for the long term. As a consequence, these self-reliant cooperatives are not experiencing the market volatility we have seen in California, and earlier in the Midwest and in other parts of the country. And, cooperatives are in the process of adding more generation facilities to serve their consumers.

In the next three years, electric cooperatives are contemplating the investment of $4.3 billion in new generation and transmission facilities. I want to emphasize again, Mr. Chairman, that these facilities are being built at the right time and in the right place to serve electric cooperative consumers. These are not plants that will sell into the market; they are designed specifically to meet the electricity needs of electric cooperatives.

Cooperatives have partnered wisely, as well, for example, with the federal Power Marketing Administrations. When no one else would, cooperatives committed to long-term power supply contracts with the PMAs. Over decades, cooperatives have built up a huge equity investment in the hydroelectric facilities of the Bureau of Reclamation or the U. S. Army Corps of Engineers, for which the PMAs provide management and marketing services.

Similarly, co-ops have partnered with the PMAs, to finance, build and maintain some 32,000 miles of high-voltage transmission lines that serve the Nation well, particularly in the West, the Upper Midwest, the Southwest.

Cooperatives Balance Energy and Environmental Concerns

Cooperatives are sensitive to balancing the Nation's energy requirements and environmental concerns. Although cooperatives own and operate only about 5 percent of the Nation's generating facilities, our portion of that generation comprises a disproportionate percentage of the total of the Nation's most advanced, state-of-the-art emissions control technology. These facilities were built in compliance with the Clean Air Act of 1972 as amended and represent an intelligent investment in future energy supply.

Some of that new investment in generation is in renewable energy resources. For example, Great River Energy, in Elk River, Minnesota has installed two megawatts of wind energy, has an additional two megawatts under construction, and announced this week that 21 megawatts will be added in 2002. Cooperatives throughout the country install solar energy for stock watering and other appropriate applications. Many cooperatives offer consumer the opportunity to designate renewable resources as their power supply options. Cooperatives in Alaska and Colorado have been the forefront of experimentation with large-scale fuel cells.

Since many electric cooperative consumers earn their living from the land, by farming, they recognize the importance of protecting and preserving that land and the air and water that surround it.

The House Agriculture Committee and this Subcommittee should be very proud of their leadership roles in seeking other renewable and emissions-control technologies and techniques that will address both energy, environmental and economic concerns.

We are excited about new emissions control techniques that are win-win situations for rural communities, utilities and agriculture, namely renewable biomass for electricity generation and the use of carbon sequestration techniques that provide income for farmers while dealing with carbon dioxide emissions. Congress is currently considering legislation to accelerate research and development to deploy these highly promising technologies, and electric cooperatives are enthusiastically supportive of that legislation.

Electric cooperatives are the only utilities in the Nation whose distribution and transmission facilities meet uniform federal engineering standards. The demonstrable effect of this is the high quality of service that is the hallmark of electric cooperatives. Just to illustrate that, Mr. Chairman, let me cite a recent national report that evaluated utility performance in restoring unexpected outages: "Rural electric cooperatives received the highest combined performance scores—104.77 on the RKS Emergency Response Performance Monitor, compared to 103 for Federal and municipal systems and 94.15 for investor-owned utilities."

If other electric utilities conformed to the high standards of electric cooperatives, problems associated with the distribution and transmission of electricity would be reduced significantly, and the quality of service would be enhanced significantly.

Cooperatives are in place and provide affordable, reliable power to support one of our Nation's most important industries – agriculture.

Coal Transportation Is a Continuing Challenge

There are continuing challenges, though. The transportation of fuel is a challenge. Generation of electricity through the use of coal comprises 51 percent of all electricity produced in the Nation. Rural electric cooperatives use coal for 75 percent of their generated electricity. It is vital that these generating facilities have the ability to enter into competitive shipping contracts with rail shippers.

Cooperatives Are Important Players in Solving National Electricity Problems

Cooperatives are—and should be—important players in solving the Nation's electricity problems. They provide a consumer-friendly yardstick of rates and services against which to measure the rest of the industry.

Consumers like co-ops. They have confidence in co-ops. As co-op members, they have can determine in great measure their own destiny. They know that they will be treated fairly. They know that their interests come first, before those of a big company seeking big profits for absentee owners.

Electric cooperatives stand ready to help meet the Nation's energy and environmental challenges. These cooperatives are a vital resource for agriculture and for rural communities.

Thank you, Mr. Chairman.